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in the

Supreme Court

of the

United States

October Term, 1972

NO. 72-1533

H. HENTZ & CO. and RALPH NERNBERG,
Petitioners,

vs.

DAVID KASNER and JOAN KASNER,
Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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H. HENTZ & CO. and RALPH NERNBERG pray that a Writ of Certiorari issue to review the Judgment and Opinion of the United States Court of Appeals for the Fifth Circuit entered in the above-entitled cause on March 15, 1973 (infra, p. A. 2, 3).

OPINIONS BELOW

The opinion of the United States Court of Appeals, Fifth Circuit, to which this Petition is directed was entered on March 15, 1973. It is unreported. (infra, p. A. 3)

JURISDICTION

The Judgment of the United States Court of Appeals, Fifth Circuit, to which this Petition is directed is unreported and was rendered under date of March 15, 1973 (infra, p. A. 2); the Opinion of the United States Court of Appeals, Fifth Circuit, upon which the aforesaid Judgment was entered, likewise was rendered under date of March 15, 1973 (infra, p. A. 3); a Petition for Rehearing was denied by that Court under date of April 4, 1973 (infra, p. A. 7); Stay of Mandate was granted to May 18, 1973 (infra, p. A. 8).

The Final Judgment for Defendants on Directed Verdict entered in the United States District Court, Southern District of Florida, by the Honorable Emmet C. Choate, Senior United States District Judge, dated January 17, 1972, and from which appeal was taken to the United States Court of Appeals, Fifth Circuit, by respondents, is unreported (infra, p. A. 10).

The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1); and pursuant to Rule 19.1(b), Supreme Court Rules. The Court of Appeals, Fifth Circuit, has rendered herein a decision in conflict with the decision of other courts of appeals on the same matter, and has decided an important question of federal law which has not been, but should be, settled by this Court.

QUESTIONS PRESENTED

I

WHETHER IN THE ABSENCE OF FRAUD AND SCIENTER DAMAGES ARE RECOVERABLE FOR ALLEGED VIOLATION OF SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 10b-5 OF THE SECURITIES EXCHANGE COMMISSION BY CUSTOMER AGAINST STOCK BROKER AND ITS REGISTERED REPRESENTATIVE FOR LOSS SUSTAINED IN A DISCRETIONARY ACCOUNT.

II

WHETHER THE MERE VIOLATION OF A RULE OR REGULATION OF A STOCK EXCHANGE GIVES RISE TO CIVIL LIABILITY.

III

WHETHER IN THOSE INSTANCES WHEREIN THE NATURE OF SECURITIES MATTER IS INTERSTATE FLA. STAT. 517.301 CONFLICTS WITH AND IS SUPERSEDED BY SECTION 10b OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 10b-5 OF THE SECURITIES EXCHANGE COMMISSION SO THAT A CIVIL ACTION PREDICATED UPON VIOLATION OF THE STATE STATUTE DOES NOT LIE.

STATUTES AND REGULATIONS INVOLVED

1. **Title 15, U.S. Code—§78j** (infra, p. A. 11) in pertinent part as follows:

"Manipulative and deceptive devices.

"It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

"(a) . . . . . .

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors"

2. **Securities Exchange Commission Rule 10b-5.**

"Employment of Manipulative and Deceptive Devices

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

"(1) to employ any device, scheme, or artifice to defraud,

"(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

3. **Florida Statutes 517.301**

"*Fraudulent transactions; falsification or concealment of facts.* — It is unlawful, and a violation of the provisions of this chapter, for any person:

"(1) in the sale or purchase of any security in this state, including any security exempted under the provisions of §517.05, and including any securities sold in any transaction exempted under the provisions of §517.06, directly or indirectly:

"(a) To employ any device, scheme or artifice to defraud;

"(b) To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary

in order to make the statements made, in the light of the circumstances under which they were made not misleading;

"(c) To engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.

"(2) To publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, communication or broadcast which though not purporting to offer a security for sale, describes such security for a consideration received or to be received directly or indirectly from an insurer, underwriter, or dealer, or from an agent or employee of an insurer, underwriter or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

"(3) In any matter within the jurisdiction of the department to knowingly and willfully falsify, conceal or cover up by any trick, scheme, or device, a material fact, or make any false, fictitious or fraudulent statement or representation, or make or use any false writing or document, knowing the same to contain any false, fictitious or fraudulent statement or entry."

STATEMENT OF THE CASE

A. HISTORY

Respondent — Dr. David Kasner, a practicing ophthalmologist, had engaged in the purchase and sale of securities in cash and margin accounts, including long and short sales and purchases, since 1961, and with H. Hentz & Co. — Petitioner through its registered representative — Ralph Nernberg — Petitioner, commencing in 1962. All transactions until September 1969 were initiated exclusively by said Respondent and without advice from either Petitioner. During the calendar year 1968 Kasner at his own instance traded in his Hentz account through Nernberg 42 sales and 15 purchases (both long and short) upon advice received from investment advisory services to which Kasner had subscribed. The account as structured at the commencement of September 1969 had suffered a decline of his cash investment of $100,000. to approximately $50,000. by reason of the market action which went against the low-priced gold stocks and the short sale of 650 shares of Honeywell, Inc. in his account. Kasner was not unknowledgeable or inexperienced in securities even though his own results were unsatisfactory.

In September 1969 Kasner consulted another brokerage firm and was advised to liquidate his position. He discussed the matter with Nernberg, indicating his intention to liquidate, and was advised that in Nernberg's judgment it would be a mistake and that he thought he could help Kasner restructure the account for a rising market and help him recoup his losses. Kasner accepted Nernberg's judgment and advice, resulting in a written discretionary authority executed November 14, 1969 (R. 241,

infra, A. 11) for the joint account of David and Joan Kasner. When Nernberg began trading the account it was already under-margined, but above maintenance requirements, and Kasner knew this. He was informed by Nernberg that to restructure the account it would have to be done by the so-called "substitution" rule of disposing of the undesired stocks and purchasing a like dollar amount of other and more diversified securities. This was done primarily between September and December 1969 during which the equity remained relatively intact. During the entire nine-month period for which claim is made by Respondents (September 1969 through May 1970) there were only nine in-and-out transactions in the account, each of which were in 100 share lots and involved different securities. All other securities acquired by substitution remained in the account through a severe bear market decline until either (a) liquidated for failure to respond to margin calls largely occurring in April and May 1970, or (b) upon the admitted direct order of Kasner to liquidate the remainder of the account on May 26, 1970—the very day when the 1970 bear market reversed itself into a booming bull market. During that interval Kasner's equity had shrunk from approximately $50,000. to $3,000. All transactions related to securities listed on the New York and American Stock Exchanges.

Kasner admitted that from September 1969 through May 1970 he had received each monthly statement from Hentz relating to his account, that he had likewise received confirmations of each and every transaction, nine margin calls in the form of letters or telegrams, seven of which occurred in April and May 1970, that he had "repeatedly" discussed the equity in his account with Nernberg during the period from January to May 1970 when the substantial

decline was occurring and was informed and knew at varying times that his equity had shrunk to $33,000., then to $28,000. and later to $22,000., but never at any time did he move to revoke the discretionary authority because he relied on Nernberg's judgment that it would be a mistake to liquidate the account and move out of the market before it turned upward — this despite the fact that in January 1970, concerned about the shrinkage in the account, Kasner admitted having again consulted the same outside brokerage firm as he had first consulted in September 1969 and having been advised again to get out of the market, which he disregarded in favor of accepting Nernberg's judgment.

Kasner testified that he knew of no fraud or fraudulent act and did not believe that Nernberg and/or Hentz committed any fraud or fraudulent act against him (R. 130); that he never doubted and does not doubt Nernberg's honesty (R. 114, 130); that Nernberg never gave or made a misstatement or a false statement to Kasner other than what he characterized Nernberg's advice that it was a mistake to get out of the market and that he could help him recoup some of his losses by restructuring the account in anticipation of a rising market (R. 131); that Nernberg never gave Kasner any misinformation about any stock bought or sold for Kasner in his account (R. 132); that he did not believe Nernberg traded the discretionary account for the purpose of generating commissions (R. 144); that he found no objection to or fault with or wrong in connection with the purchase or sale of any individual security or transaction in his account. (R. 128)

The trial judge found as a matter of law that there was no "churning" (R. 214); that admittedly not a single

purchase was bad other than that the market went down (R. 210); that Respondents knew and were aware by their own admission of the downgrade in the market generally (R. 209); that the proof not only failed to establish negligence, but it did not establish mishandling of the account (R. 218); that "in other words all we found, in my opinion, does not violate the Securities Act and does not constitute negligence to make them responsible for any losses incurred." (R. 219-220)

At the conclusion of presentation of Plaintiffs'-Respondents' case, Petitioners moved for a directed verdict, and the court after hearing extensive argument granted the motion, entered a Directed Verdict, and thereafter the Final Judgment for Defendants on Directed Jury Verdict (infra, p. A. 10). From that Final Judgment Respondents filed their Appeal to the United States Court of Appeals, Fifth Circuit, resulting in the decision Reversing and Remanding for new trial (infra, p. A. 2, 3). This Petition for Writ of Certiorari is directed thereto.

B. BASIS FOR FEDERAL JURISDICTION IN THE UNITED STATES DISTRICT COURT.

Respondents alleged in their Complaint jurisdiction in the United States District Court under and by virtue of Sections 6(b) (15 U.S.C. §78(f)); 10(b) (15 U.S.C. §78(j); 15(c)(1)-(2) (15 U.S.C. §78 (0)(c)(1)-(2); 27 (15 U.S.C. §78(aa)) of the Securities Act of 1934; and Rules 10b-5 and 15 (c)(1)-(2) of the Securities Exchange Commission; and pendent jurisdiction of the causes of action arising under state law.

The United States Court of Appeals, Fifth Circuit, in its opinion (infra, p. A. 3) found jurisdiction under 28 U.S.C. §§1331 and 1337; §22(a) of the Securities Act of 1933 [15 U.S.C. §77v(a)], and §27 of the Securities Exchange Act of 1934 [15 U.S.C. §78aa]; and pendent jurisdiction over the counts alleging state securities law violations and common law negligence.

REASONS FOR GRANTING THE WRIT

I

A. FRAUD v. NEGLIGENCE — 10b-5

The United States Court of Appeals, Second Circuit, in a recent case, CCH Fed. SEC Rptr. #93,959 (2nd Cir. 1973), *Frank Lanza, Jr., Vincent Sharbo, et al., v. Drexel & Co., John Ames Ballard, Bertram D. Coleman, et al.*, decided April 26, 1973, bearing Docket No. 35794, stated with regard to the necessity of fraud as distinguished from negligence in the maintenance of a civil action for violation of 10b-5 as follows:

> "We recognize, of course, that other circuits have expressed approval of a 'negligence' standard. *See, e.g., Ellis v. Carter*, 291 F.2d 270, 274 (9th Cir. 1961). But we do not find these statements persuasive. In addition to the inappropriateness of a negligence standard demonstrated by comparing liability under Section 10b of the Securities Exchange Act with liability under Section 11 of the Securities Act, *supra*, we believe the actual language of Section 10b bars adoption of a negligence standard. Rule 10b-5(b), the

> provision under which the Lanzas seek relief, makes it unlawful 'to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading . . . . ' Yet the rule-making power granted to the Securities and Exchange Commission by Section 10b authorizes rules making it unlawful '[t]o use or employ . . . any *manipulative* or *deceptive* device or contrivance . . . ' (emphasis added). These words negate liability for a mere negligent omission or misrepresentation. Rather, 'proof of fraud is required in suits under §10b of the 1934 Act and Rule X-10b-5 . . . ' *Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783, 786 (2d Cir. 1951). *See*, VI Loss, Securities Regulations 3884-86."

To like effect see also *Shemtob v. Shearson, Hammill & Co.* (C.A. 2, 1971) 448 F.2d 442.

In the Eighth Circuit, Rule 10b-5 applies to negligent as well as fraudulent misrepresentations. *Vanderboom v. Sexton*, 422 F.2d 1233, 1238 (C.A. 8-1970). Likewise, in *Myzell v. Fields*, 386 F.2d 718 (C.A. 8-1967), cert. denied, 88 S.Ct. 1043, 390 U.S. 951, 19 L.Ed. 2d, 1143, that court stated: "The present rule in the Eighth Circuit is that Rule 10b-5 applies to negligent as well as intentional misrepresentations."

The Ninth Circuit held in *Ellis v. Carter*, 291 F.2d 270 (C.A. 9-1961) that in a 10b-5 action one need not establish genuine fraud as distinguished from mere misstatement or omission. As observed by a commentator, *Bucklo, Scienter*

and Rule 10b-5, 67 N.W.U. L.Rev. 562, 565 (1972) this case and statement have subsequently been cited as prohibiting not only negligent, but even innocent misstatements.

The Seventh Circuit in *Carroll v. First National Bank of Lincolnwood*, 413 F.2d 353 (C.A. 7-1969), cert. denied, 90 S.Ct. 552, 396 U.S. 1003, 24 L.Ed. 494, interpreted 10b-5 to "prohibit all fraudulent schemes in connection with purchase or sale of securities, whether the artifices employed involve a garden-type variety of fraud or present a unique form of deception."

The Fifth Circuit in *Clement A. Evans & Co. v. McAlpine*, 434 F.2d 100, 104 (C.A. 5-1970), cert. denied, 91 S.Ct., 1660 (1971), in laying down a diligence-negligence test for plaintiffs quoted the Eighth Circuit language in *City National Bank of Fort Smith, Ark. v. Vanderboom*, 422 F.2d, 221 (8th Cir. 1970), cert. denied, 399 U.S. 905, 90 S.Ct. 2196, 26 L.Ed.2d, 560, creating a diligence-negligence standard for defendants and proceeded to state that its test for plaintiffs, though first suggested "in the context of negligent misrepresentations (by defendants) . . . is not altered merely because the misrepresentations are alleged to be intentional rather than negligent."

Relating the aforegoing to the case at bar, it is pertinent to examine the direct testimony with regard to *fraud* appearing in the record wherein Kasner, under cross-examination (R. 130) testified as follows:

> "Q. (Mr. Aronovitz) Now, what was it that Mr. Nernberg did or did not do that you say constituted fraudulent action on his part for fraud?

"A. (Dr. Kasner) He mismanaged the account.

"Q. What particular act did he do that you consider to have been fraudulent?

"Mr. Nachwalter: Your Honor, that calls for a legal conclusion. We are talking about fraud in the equitable sense —

"(162) The Court: I think that is important. Mismanagement and fraud are two different animals.

"Mr. Nachwalter: Mr. Aronovitz uses the term —

"The Court: Remember how many cases you mismanaged, and how many more I mismanaged? It was not fraud.

"Mr. Nachwalter: Well, your Honor, the term 'fraud' is used in the complaint in this case in an equitable sense under the securities laws.

"The Court: The Securities Exchange did not change the definition of the word fraud. Fraud means evil, deliberate, conscientious (sic). I think this honest witness is telling the truth. *He says it was just plain inability to manage the account.*

"So he is asking, was that fraud or mismanagement, which it was. If it is fraud, let us define wherein and whereby it was fraud. That is the proper question.

"Q. (Mr. Aronovitz) Your answer is there was no fraud in your definition of the term?

"A. Excuse me?

"Q. Then your answer is that there is no (163) fraud in your definition of the term?

"A. *No, there wasn't fraud. I never doubted the man's honesty.* What I'm trying to point out was, I felt there was incompetence. As a doctor, I looked upon this as malpractice. You know, I can think in terms of medicine better than I can in terms of —" (Emphasis supplied.)

So, there was no fraud. Therefore, it is difficult to comprehend how the appellate court construed a violation of 10b-5 to be maintainable unless the alleged violations to which it referred in recognizing the first theory of the plaintiffs cause of action were related to negligence as applied to 10b-5 or negligent misrepresentations applied to 10b-5. Consequently, the Fifth Circuit has thereby recognized a standard *other* than fraud as the basis for alleging a civil action for damages in violation of 10b-5. See the first paragraph of the Fifth Circuit Court's opinion (infra, p. A. 3) wherein it designated the first of three theories by which plaintiffs sought recovery as "(1) violations of 15 U.S.C. 78j, 15 U.S.C. §780(c)(1)-(2) and Securities Exchange Commission Rules 10b-5 and 15(c)(1)-(2) promulgated thereunder." This view is confirmed by the direction expressed in *Evans v. McAlpine*, supra, relating to the diligence-negligence standard.

By reason of the aforegoing, it is respectfully suggested that the several courts of appeals have rendered decisions in conflict with each other, and that the decision of the Fifth Circuit in the instant case is in conflict with some of those other decisions; and that this presents an important question of federal law which has not been, but should be, settled by this Court.

B. SCIENTER — 10b-5

The Second Circuit in *Lanza, et al. v. Drexel & Co., et al., supra,* stated and held with regard to the necessity of scienter in a 10b-5 action as follows:

> " . . . . Although one commentator recently stated that 'The question whether scienter is a required element under rule 10b-5 . . . must be regarded as open at this time [because] [t]he circuit courts are either split or in confusion,' Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution,* 120 U. Pa. L. Rev. 597, 631 (1972), our recent decision in *Shemtob v. Shearson, Hammill & Co., supra,* eliminated any doubt that proof of scienter is required in private actions in this circuit. There, in the context of a private action for damages, we stated that no violation of Rule 10b-5 occurs 'in the absence of allegations of facts amounting to *scienter,* intent to defraud, reckless disregard for the truth, or knowing use of a device, scheme, or artifices to defraud. It is insufficient to allege mere negligence.' 448 F.2d at 445. Under the *Shemtob* test, a plaintiff claiming a violation of Rule 10b-5 who cannot prove that the defendant had actual knowledge of any misrepresentations and omissions must establish, in order to succeed in his action, that the defendant's failure to discover the misrepresentations and omissions amounted to a willful, deliberate, or reckless disregard for the truth that is the equivalent of knowledge."

The Eighth Circuit in *Myzell v. Fields*, supra, held that proof of *scienter* is *not required* under 10b-5. See also *City National Bank v. Vanderboom*, supra, and *Vanderboom v. Sexton*, supra. It was held in *S.E.C. v. Van Horn*, 371 F.2d 181 (C.A. 7-1966) that proof of scienter or fraudulent intent is not essential in a suit for injunctive relief.

Ellis v. Carter, supra, has been indicated as a holding by the Ninth Circuit rejecting a scienter requirement. *Bucklo*, supra, page 565. The latter author points out that the use of ambiguous language may be a principal cause of confusion, and suggests that much of the confusion surrounding the scienter requirement can be dispelled if greater concern were evidenced by the meaning of the phrases used in some of the decisions relating thereto.

The language used by the Fifth Circuit in *Evans v. McAlpine*, supra, strongly suggests that the Fifth Circuit is prepared to treat defendants' negligence as a sufficient scienter for 10b-5. The holding in the case at bar confirms this when related to the opinion herein finding jury issues on remand limited to the simple determination "of whether false statements were made, if so whether they were material, and if plaintiffs were justified in their reliance thereon," (and citing *Evans v. McAlpine* as authority) inasmuch as such a standard for assessment of liability completely ignores the element of scienter. Consequently, this places the instant decision of the Fifth Circuit in conflict with *Lanza* and *Shemtob* of the Second Circuit, but in apparent conformity with *Vanderboom* in the Eighth Circuit, and confirms the direction indicated in *Evans v. McAlpine*, supra.

By reason of the aforegoing, it is respectfully suggested that the several courts of appeals have rendered decisions in conflict with each other, and that the decision of the Fifth Circuit in the instant case is in conflict with some of those other decisions; and that this presents an important question of federal law which has not been, but should be, settled by this Court.

C. INSUROR-GUARANTOR OF DISCRETIONARY ACCOUNT

Ancillary to the first question presented herein, it should be noted that the effect of the appellate court decision, *in the absence of fraud*, has the effect of making the stock broker and registered representative guarantors-insurors against losses in a discretionary account. An agent, in the absence of an express agreement is not an insuror of the success of his undertaking and does not guarantee the principal against incidental losses or undertake that he will commit no errors or mistakes. See 3 C.J.S. 36 (Agency, §156); *Hecht v. Harris, Upham & Co.*, 283 F.Supp. 417, 430 (N.D.Cal. 1968). There was no express agreement herein alleged or proven between either Hentz or Nernberg and the Kasners. A holding that the broker or agent is liable for damages occurring in a severe bear market decline, and resulting from the management of a discretionary account, in the absence of fraud, has the effect of making the broker and the agent the insuror or guarantor of the customer's account against loss. This was never intended to be the type of protection afforded an investor by the Securities Acts or the Rules promulgated thereunder.

II

VIOLATION OF STOCK EXCHANGE RULE

Even the violation of a statute or ordinance does not in every instance give rise to a civil cause of action. In *Rospigliasi v. Clogher*, 46 So.2d 170 (Fla. 1950), the Supreme Court of Florida held that a violation of a rule of the New York Stock Exchange would not have such force and dignity that violation of it would be a transgression of the federal statute creating the Securities and Exchange Commission which in turn supervised the New York Stock Exchange. It differentiates between rules and regulations promulgated by the Securities and Exchange Commission under direct authority of the federal statute, as distinguished from rules governing the operation of and adopted by the New York Stock Exchange.

The aforegoing decision of the Florida Supreme Court is consistent with the principle generally observed that mere violation of a rule or regulation of a stock exchange does not of itself, per se, give rise to a civil cause of action. *Nichols & Co. v. Columbus Credit Corp.*, 126 N.Y.S. 2d 715, aff'd. 134 N.Y.S. 2d 590; *Irving Weis & Co. v. Offenberger*, 220 N.Y.S. 2d 1001; *Whyte v. New York Mercantile Exchange*, 233 N.Y.S. 2d 37.

The second theory recognized by the Fifth Circuit as applicable herein is "(2) Negligent failure to properly supervise and administer a discretionary account in violation of New York Stock Exchange Rules 401 and 405." This apparently purports to be founded upon common law negligence under state law—but Rules 401 and 405 of the New York Stock Exchange were promulgated in New York,

the account was handled in Florida, part of the supervision occurred in New York and part in Florida, so there is doubt as to whether this is common law negligence and strictly a state-founded theory. Additionally, it should be noted that there is *no* diversity of citizenship in this cause of action, and if in fact there *never* was fraud as Kasner admitted and therefore no cause of action for violation of 10b-5, then pendent jurisdiction was lacking ab initio on this state-founded claim or federal claim not involving a federal question. It was within the discretion of the trial judge even at a point during or at the end of trial to either dispose of a state-founded claim or not to do so. *United Mineworkers v. Gibbs*, (1966) 86 S.Ct. 1130, 373 U.S. 715, 16 L.Ed.2d 218. Finally, as previously observed, the trial court found as a matter of law that there was no negligence as shown by the testimony (R. 219-20).

III

CIVIL ACTION ON F.S. 517.301

All securities transactions involved in this litigation occurred on the New York and American Stock Exchanges in New York City. No securities originated by or issued out of the State of Florida or registered therein were involved. The mails were extensively used to transmit confirmations, margin calls, monthly statements and the telephone was likewise used extensively. It therefore appears that the nature and scope of the transactions involved were interstate in character.

A comparison, element by element, of F.S. 517.301 with Rule 10b-5 indicates the close approximation between

the two. Also, it becomes apparent immediately that both are predicated upon fraud. Again, we observe that if, as Kasner indicates, there was no fraud and he does not charge it against Petitioners, then there could be no violation of F.S. 517.301.

It likewise seems that notwithstanding the "savings clauses" appearing at 15 U.S.C. 77c (a) (11), 77 p, 77r, nevertheless because the transactions involved are interstate as contrasted with intra-state in nature, there is a conflict between the application of Rule 10b-5 and F.S. 517.301. See *Rice v. Board of Trade*, 331 U.S. 247, 67 S.Ct. 1160, 91 L.Ed. 1468; *Crosby v. Weil*, 382 Ill. 538, 48 N.E.2d 386, 145 A.L.R. 1252. The Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state law on the same subject. *Hines v. Davidowitz*, 312 U.S. 52, 61 S.Ct. 399, 85 L.Ed. 581. If the area covered by F.S. 517.301 has been pre-empted, then no civil cause of action should lie for damages thereunder.

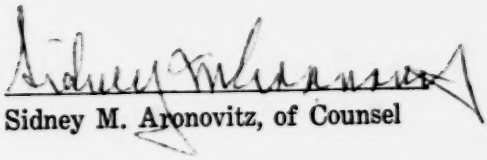
We submit to the Court that this is a matter of great public interest for determination of whether or not a state statute closely paralleling Rule 10b-5 and founded upon the same relative elements can be supported in a securities matter interstate in nature as the basis for a civil action for its violation, or whether the state statute is not rendered repugnant to and superseded by the federal rule and statute. This affects the securities laws of a number of states.

CONCLUSION

For the reasons stated, this Petition for Writ of Certiorari should be granted. The issues suggested for retrial on the facts by the appellate court are all resolved as a matter of law and were so resolved by the trial court and argued herein accordingly.

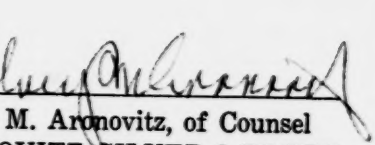
Respectfully submitted,

ARONOVITZ, SILVER & BOOTH
908 Ainsley Building
Miami, Florida 33132
Attorneys for Petitioners

By 
Sidney M. Aronovitz, of Counsel

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that three copies of the aforegoing Petition for Writ of Certiorari and Appendix annexed thereto were served upon Michael Nachwalter, Esquire, of Kelly, Black, Black & Kenny, P.A., 1409 Alfred I. duPont Building, Miami, Florida 33131, counsel for David Kasner and Joan Kasner, Respondents, by depositing same in a United States mail box with first class postage prepaid, addressed accordingly, and in accordance with Rule 33, Supreme Court Rules, this 11 day of May 1973.

By 

Sidney M. Aronovitz, of Counsel
ARONOVITZ, SILVER & BOOTH
908 Ainsley Building
Miami, Florida 33132
Attorneys for Petitioners

APPENDIX

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1972

No. 72-1575

D. C. Docket No. CA 70-1853

DAVID KASNER and JOAN KASNER,
Plaintiffs-Appellants,

versus

H. HENTZ & CO. and RALPH NERNBERG,
Defendants-Appellees.

Appeal from the United States District Court for the Southern District of Florida

---

Before BROWN, Chief Judge, TUTTLE and INGRAHAM, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Florida, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the order of the District Court appealed from, in this cause be, and the same is hereby, reversed; and that this cause be, and the same is hereby remanded to the said District Court in accordance with the opinion of this Court;

It is further ordered that defendants-appellees pay to plaintiffs-appellants the costs on appeal to be taxed by the Clerk of this Court.

March 15, 1973

Issued as Mandate:

APPENDIX B

[TITLE OMITTED]

(March 15, 1973)

Before BROWN, Chief Judge, TUTTLE and INGRAHAM, Circuit Judges.

INGRAHAM, Circuit Judge: Plaintiffs-appellants, customers of H. Hentz & Co., a brokerage firm, brought suit against the firm and Ralph Nernberg, its registered agent, to recover damages allegedly occasioned by Nernberg's false dealings and breach of trust in handling plaintiffs' discretionary stock account. More particularly, plaintiffs sought damages from Nernberg and Hentz on three theories: (1) violations of 15 U.S.C. §78j, 15 U.S.C. § 78o(c)(1)-(2) and Securities Exchange Commission Rules 10b-5 and 15(c)(1)-(2) promulgated thereunder; (2) negligent failure to properly supervise and administer a discretionary account in violation of New York Stock Exchange Rules 401 and 405 and (3) violations of the applicable securities laws, Florida Statutes Annotated § 517.301.

Jurisdiction was asserted and is found under 28 U.S.C. §§ 1331 and 1337; § 22(a) of the Securities Act of 1933 [15 U.S.C. § 77v(a)], and § 27 of the Securities Exchange Act of 1934 [15 U.S.C. § 78aa]. Pendant jurisdiction over plaintiffs' counts alleging state securities law violations and common law negligence is also present. McCurnin v. Kohlmeyer & Co., ____ F.2d ____ (5th Cir., 1973) [No. 72-3175, February 13, 1973].

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Florida, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the order of the District Court appealed from, in this cause be, and the same is hereby, reversed; and that this cause be, and the same is hereby remanded to the said District Court in accordance with the opinion of this Court;

It is further ordered that defendants-appellees pay to plaintiffs-appellants the costs on appeal to be taxed by the Clerk of this Court.

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INGRAHAM, Circuit Judge: Plaintiffs-appellants, customers of H. Hentz & Co., a brokerage firm, brought suit against the firm and Ralph Nernberg, its registered agent, to recover damages allegedly occasioned by Nernberg's false dealings and breach of trust in handling plaintiffs' discretionary stock account. More particularly, plaintiffs sought damages from Nernberg and Hentz on three theories: (1) violations of 15 U.S.C. §78j, 15 U.S.C. § 78o(c)(1)-(2) and Securities Exchange Commission Rules 10b-5 and 15(c)(1)-(2) promulgated thereunder; (2) negligent failure to properly supervise and administer a discretionary account in violation of New York Stock Exchange Rules 401 and 405 and (3) violations of the applicable securities laws, Florida Statutes Annotated § 517.301.

Jurisdiction was asserted and is found under 28 U.S.C. §§ 1331 and 1337; § 22(a) of the Securities Act of 1933 [15 U.S.C. § 77v(a)], and § 27 of the Securities Exchange Act of 1934 [15 U.S.C. § 78aa]. Pendant jurisdiction over plaintiffs' counts alleging state securities law violations and common law negligence is also present. McCurnin v. Kohlmeyer & Co., ___ F.2d ___ (5th Cir., 1973) [No. 72-3175, February 13, 1973].

The gravamen of plaintiffs' complaint was that after suffering near disastrous losses in the stock market with a portfolio structured for a market decline, Dr. and Mrs. Kasner approached their broker Nernberg in September of 1969, intending to direct him to liquidate their holdings. Rather than lose an actively trading account and its attendant commissions, Nernberg, plaintiffs' allege, induced the Kasners to give him trading authority over their stock portfolio and to restructure it for a rising market. Plaintiffs testified that when they approached Nernberg to liquidate their holdings, he said to them:

> "And he said to me this would be [the] worst mistake you could make. Let me turn it around, and I'll make your money back in two years; and that he would be the manager of the account. He would take it off my hands, I wouldn't have to worry about it, I could go back to my doctoring, and I wouldn't have to look at these statements — I couldn't read anyway — No matter what they said, I couldn't read these statements; I didn't understand them. And so he offered me to take it over, he would manage it — he was an expert, a professional. I'd already learned that I could not handle the account any more; I was an amateur. I couldn't learn enough to handle this stuff. So — And here he was offering me to take it off my hands, take it over, make money back in two years.
>
> "I said, "Fine, then take it over,' and that's essentially how he got the account."

In support of the Kasner's allegations that Nernberg had induced them to remain in the market with a disastrous result, plaintiffs introduced the discretionary authorization they had executed in Nernberg's favor in September of 1969. They also introduced evidence which showed that when signed over to Nernberg's discretion plaintiffs' portfolio, though below margin requirements, had a net equity in excess of $50,000. Less than nine months later, after active trading by Nernberg and maintenance calls, plaintiffs' equity in the account had been reduced to about $3000. Plaintiffs further showed that all transactions occurring in this period of time were initiated solely by defendant Nernberg under the supervision of Hentz & Co. and that plaintiffs had continued the account only at Nernberg's insistence.

In defense of the action Hentz relied on the testimony of Nernberg that he had not guaranteed results, nor that he had fraudulently or negligently managed the account. Defendants further relied on evidence that in the course of the decline in plaintiffs' equity, they had sent plaintiffs numerous notifications that their account was declining. The defense contended that given such knowledge plaintiffs could not justifiably have relied on Nernberg's management. At the close of the testimony on defendants' motion, the district court granted a directed verdict for the defendants.

We reverse as jury questions on several controverted facts appear in this record. Boeing v. Shipman, 411 F.2d 365 (5th Cir., 1969), required that the case be submitted to the jury, the appropriate forum for determination of whether false statements were made, if so whether they were material, and if plaintiffs were justified in their

reliance thereon. Evans & Co. v. McAlpine, 434 F.2d 100 (5th Cir., 1971); Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876 (2nd Cir., 1972); Robinson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 337 F.Supp. 107 (N.D. Ala., 1971); Hecht v. Harris, Upham & Co., 283 F.Supp. 417 (N.D. Calif., 1968); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bocock, 247 F.Supp. 373 (S.D. Tex., 1965).

In arguments over the motion for directed verdict, plaintiffs suggested that the case already tried be sent to the jury which had heard it, then should the verdict be against defendants the court could properly consider a defense motion for a judgment n.o.v., which, should the court grant it and later be reversed, would obviate the need for a retrial. This suggestion was not followed and we consequently must remand this cause for re-trial.

The order of the district court is REVERSED and the cause REMANDED.

APPENDIX C

(Titled Omitted)

[Filed April 4, 1973]

ON PETITION FOR REHEARING

(April 4, 1973)

Before BROWN, Chief Judge, TUTTLE and INGRAHAM, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby denied.

APPENDIX D

[TITLE OMITTED]

April 18, 1973

Messrs. Sidney M. Aronovitz

Richard R. Booth

Attorneys at Law
908 Ainsley Building
Miami, Florida 33132

No. 72-1575 — David Kasner and Joan Kasner vs.

H. Hentz & Co. and Ralph Nernberg

MANDATE STAYED TO: May 18, 1973

Dear Sir:

The court has this day granted a stay of the issuance of the mandate to the date as shown above. If during the period of the stay there is filed with the clerk of this court a notice from the clerk of the Supreme Court that the party who has obtained the stay has filed a petition for the writ in that court, the stay shall continue until final disposition by the Supreme Court. Upon the filing of a copy of an order of the Supreme Court denying the petition for writ of certiorari the mandate shall issue immediately under Rule 41, FRAP.

Under revised Rule 21(1) of the Supreme Court effective July 1, 1970, a record is no longer required in connection with an application for writ of certiorari, and therefore will not be routinely prepared by this office (38LW 3502).

Enclosed is a copy of the opinion, judgment and order denying rehearing which are still required by the Supreme Court to be incorporated as an appendix to your petition.

Very truly yours,

EDWARD W. WADSWORTH,
Clerk

By /s/Maryette K. Farley
Deputy Clerk

enc.

cc: Mr. Michael Nachwalter

APPENDIX E

[TITLE OMITTED]

[Filed January 17, 1972]

FINAL JUDGMENT FOR DEFENDANTS ON DIRECTED JURY VERDICT

This cause came on for trial before the court and a jury. The plaintiffs having presented their case and issues in full and having thereupon rested, the defendants, H. Hentz & Co., a partnership, and Ralph Nernberg, jointly and severally, moved for the entry of a directed verdict for the defendants. The court, after hearing argument by respective counsel and being otherwise fully advised in the premises, thereupon directed the entry of a verdict by the jury for the defendants, H. Hentz & Co. and Ralph Nernberg, jointly and severally, on each count of the complaint, namely, Counts I, II, III and IV. It is, accordingly,

ORDERED and ADJUDGED that the plaintiffs, David and Joan Kasner, take nothing, that the action upon plaintiffs' complaint is dismissed on the merits, and that each party shall bear his own costs. It is further

ORDERED and ADJUDGED that the motion of the defendant, H. Hentz & Co. to dismiss its counterclaim is granted, and the counterclaim is dismissed.

DONE and ORDERED at Miami, Florida, this 17th day of January, 1972,

EMMET C. CHOATE
SENIOR UNITED STATES
DISTRICT JUDGE

APPENDIX F

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
June 6, 1934, c. 404, § 10, 48 Stat. 891.

APPENDIX G

TRADING AUTHORIZATION LIMITED TO PURCHASES AND SALES OF SECURITIES AND COMMODITIES

MESSRS. H. HENTZ & CO.
72 Wall Street
New York 5, N.Y.

Dear Sirs:

I hereby authorize RALPH NERNBERG whose address is 2020 Country Club Prado, C. Gables, Florida, to

buy, sell and trade in for my account and risk and in my name, stocks, bonds and any other securities and/or commodities and/or contracts relating to the same, on margin or otherwise and in accordance with your terms and conditions. In all such purchases, sales or trades he is authorized to act for me and in my behalf in the same manner and with the same force and effect as I might or could do if personally present, and you are authorized to follow his instructions in every respect concerning my account(s) with you; and I hereby agree to hold you harmless from any to pay you promptly on demand any and all losses arising therefrom or debit balances due thereon.

This authorization and this indemnity shall be continuing and shall remain in full force and effect until you receive from me written notice of my revocation thereof, and shall inure to the benefit of your firm, its successors and assigns, irrespective of any change or changes at any time in the personnel of your said firm, its successors and assigns for any cause whatsoever.

/s/ David Kasner

/s/ Joan Kasner

Dated, Nov. 14, 1969

Specimen signature of authorized Agent:

/s/ Ralph A. Nernberg

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in the

Supreme Court

of the

United States

OCTOBER TERM, 1972

No. 72-1533

H. HENTZ & CO. and RALPH NERNBERG,
Petitioners,

vs.

DAVID KASNER and JOAN KASNER,
Respondents.

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

(Appendix contained herein)

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 475 F.2d 119 (5th Cir., 1973) and is included herein in the Appendix. (*Infra* A.1)

JURISDICTION

The judgment of the Court of Appeals was entered on March 15, 1973. Rehearing was denied on April 4, 1973. The petition for a writ of certiorari was filed on or about May 14, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

I

WAS THE COURT OF APPEALS CORRECT IN HOLDING THAT THE CASE SHOULD HAVE GONE TO THE JURY ON THE ISSUE OF LIABILITY UNDER RULE 10b-5?

II

WAS THE COURT OF APPEALS CORRECT IN HOLDING THAT THE CASE SHOULD HAVE GONE TO THE JURY ON THE ISSUES OF NEGLIGENCE, NEGLIGENT MISREPRESENTATIONS, RULE 405, AND VIOLATIONS OF THE FLORIDA STATUTES?

III

DID THE COURT HAVE JURISDICTION OF CLAIMS ARISING UNDER STATE LAW UNDER PENDENT JURISDICTION?

STATEMENT OF THE CASE

In September of 1969, the defendant brokerage house H. Hentz & Company by and through its registered representative Ralph Nernberg talked the plaintiffs David and Joan Kasner, his wife, customers of the defendants, out of leaving the stock market and into giving defendant Nernberg discretionary authority over their account by telling the plaintiffs that Nernberg could "turn the account around" and make back in two years all the plaintiffs had previously lost in the market. (R.113-116, 118, 148-149, 175, 187-189). When the plaintiffs succumbed to this solicitation and misrepresentation by Nernberg in Sep-

tember of 1969, the account had an equity value of $53,000. Seven short months later in May of 1970, when Hentz and Nernberg surrendered the discretionary authority and returned what was left of the account to the plaintiffs, only $3,000 remained. (R.131-133 Plaintiffs' Exhibit No. 7A). The plaintiffs then brought this action against Hentz and Ralph Nernberg under Section 10 of the Securities Exchange Act of 1934 and Regulation 10b-5 of the Securities Exchange Commission issued thereunder, Rule 405 of the New York Stock Exchange Rules, the Florida Statutes and for negligence. The case of the plaintiffs essentially rested on the theories that defendants Nernberg and Hentz talked them out of leaving the market and into giving defendant Nernberg discretionary authority over their account by misrepresentation and material non-disclosure; and that defendants had breached their fiduciary obligations to the plaintiffs by recklessly subjecting the plaintiffs to undue risk of margin calls on market drops without disclosing this to the plaintiffs, finally resulting in a forced sell-off of the bulk of the plaintiffs' securities at sacrifice prices. The plaintiffs also showed negligent supervision of Nernberg by Hentz since this special type account was never given the close watching Hentz admitted was called for. (R.46, 57, 204-207, 209-211).

Although the plaintiffs proved each and every fact in the complaint, the trial court nevertheless directed a verdict at the end of the plaintiffs' case and took the case away from the jury.

The plaintiffs appealed and the Court of Appeals for the Fifth Circuit reversed and remanded the case for trial, 475 F.2d 121 (5th Cir. 1973). The defendants then moved for a rehearing which was denied.

ARGUMENT

I.

THE COURT OF APPEALS WAS CORRECT IN HOLDING THAT THE CASE SHOULD HAVE GONE TO THE JURY ON THE ISSUE OF LIABILITY UNDER RULE 10b-5.

In this case the Court of Appeals, on the authority of *Boeing Company v. Shipman,* 411 F.2d 365 (5th Cir. 1969) reversed the trial judge because he directed a verdict in a case which had jury questions. The defendants' attempt to create conflicts in Circuits is misplaced in this case where a reversal was granted because a trial judge took away a jury's right to determine questions which should have properly been submitted to them.

A. The Relationship Between The Parties

The defendants do not contest three important facts in the Petition. Firstly, Nernberg and Hentz had discretionary authority in the Kasner account in September of 1969. As a Vice President of Hentz admitted, a discretionary account means that a customer turns over his account to the registered representative (here Nernberg) and tells him "Handle the account for me; watch it for me." (R.45, 102). Secondly, once the defendants took discretionary authority in the Kasners' account, they owed the Kasners a much higher duty than they would have in a normal account (R. 46, 57, 64-65, 210, 211, 299); and, thirdly, the discretionary account created a fiduciary relationship between the parties.

B. Fraud and Deception Under The Federal Securities Laws

Defendants in their Petition would like to revert to restrictive and narrow common law definitions of "fraud" and apply these definitions to the Securities laws. Such a step-back in the law is not warranted.

The breadth of the concept of fraud and deception under Rule 10b-5 of the Securities Act is demonstrated by the case of *Affiliated Ute Citizens v. United States,* 406 U.S. 128, 31 L.Ed. 2d 741, 760 (1972) wherein this court stated that the proscriptions of this Rule (10b-5):

> "are broad and by repeated use of the word 'any' are obviously meant to be inclusive. The Court has said that the 1934 Act and its companion legislative enactments embrace a 'fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry.' *Securities & Exchange Commission v. Capital Gains Research Bureau,* 375 US 180, 186, 11 L Ed 2d 237, 243, 84 S. Ct. 275 (1963). In the case just cited the Court noted that Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed 'not technically and restrictively, but flexibly to effecuate its remedial purposes.' Id., at 11 L Ed. 2d at 248. This was recently said once again in *Superintendent of Insurance v. Bankers Life & Casualty Co.,* 404 US 6, 30 L.Ed. 2d 128, 92 S.Ct. 165 (1971.)"

Section 10b-5 also applies to breaches of a fiduciary relationship, (as exists here) for this Court held in *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed. 2d 128, 133-134 (1971) that for conduct that constitutes a "disregard of trust relationships by those whom the law should regard as fiduciaries . . . there is redress under §10(b) . . . ."

Defendants by their own admission had a duty to disclose to plaintiffs the status and severe jeopardy in their account, and to watch the account and supervise it (R. 46, 57, 64-65, 209-211). Yet, defendants nowhere in their Petition allege that they ever informed the Kasners of the maintenance level in their account, or the jeopardy that defendants had created in the account. Nor do the defendants contest plaintiffs' claim of lack of supervision by Hentz over this discretionary account.

This court also held in the *Affiliated Ute Citizens* case, *supra*, 31 L.Ed. 2d at 761-762 that where one has a duty under Rule 10b-5 to disclose material information, "positive proof of reliance is not a prerequisite to recovery." The Court said that if the facts withheld are material, then the obligation to disclose them, coupled with the actual omission, establish the requisite element of causation in fact.

It cannot be seriously contended that failing to disclose to the Kasners the status of their account and the severe jeopardy it was in was not material. (R. 123-124, 176-177, 187-189).

When the nondisclosures are coupled with Nernberg's misrepresentations and Hentz's lack of supervision, the conduct of defendants clearly amounted to a fraudulent or deceptive course of business contrary to the stated purposes of Rule 10b-5 which are "to protect the investing public and to secure fair dealing in the securities market". *Herpich v. Wallace*, 430 F.2d 792 (5th Cir. 1970), *S.E.C. v. Texas Gulf Sulfur Co.*, 401 F.2d 833 (2d Cir. 1968).

C. The Liability of Hentz

Firstly, Hentz has never disputed that Nernberg was their agent so that if he is liable — they are liable. Secondly, defendant Hentz is liable as a controlling person as defined in Section 20 of the Act (15 U.S.C. §78[t]).

The case of *Lorentz v. Watson*, 258 F.Supp. 724, 733 (E.D. Pa. 1966) discusses the liability of controlling persons and cites from the case of *Reynolds & Co., et al.*, 39 S.E.C. 902 (1960) wherein the Commission pointed out that when a securities firm fails to properly supervise and watch out for the interests of its customers so as to prevent misconduct in the handling of the accounts of such customers, the brokerage house is equally liable, and such failure is sufficient to give rise to liability under Rule 10b-5. Hentz's failure in this case to supervise its agent in this discretionary account, and to watch it as they admit they had a duty to do, establishes their liability — or at the very least presents a jury question.

II.

THE COURT OF APPEALS WAS CORRECT IN HOLDING THAT THE ISSUES OF NEGLIGENCE, NEGLIGENT MISREPRESENTATIONS, VIOLATIONS OF RULE 405, AND VIOLATIONS OF THE FLORIDA STATUTES SHOULD HAVE GONE TO THE JURY.

A. Negligence

Plaintiffs charged the defendants with negligent supervision over the account, negligent management of the account and negligent misrepresentations. It is obvious that these questions were at issue in the case since defendants pleaded and argued affirmative defenses such as contributory negligence and assumption of the risk (R. 30-31), and the Court directed a verdict on the questions of negligence. (R. 270-271)

The question of common law negligence was certainly a jury question, and the Fifth Circuit in reversing the trial judge in this case, so held.

B. Negligent Misrepresentations

Under the law of Florida, negligent misstatements are sufficient to establish liability. This was pointed out by the Fifth Circuit in *Bobby Jones Garden Apartments, Inc. v. Suleski*, 391 F.2d 172, 177-178 (5th Cir. 1968) citing the Florida cases of *Kutner v. Kalish*, 173 So.2d 763 (Fla. Dist. Ct. App. 1965); *Joiner v. McCullers*, 28 So.2d 823 (Fla. 1947); *Watson v. Jones*, 25 So. 823 (1899) and *Wheeler v. Baars*, 16 So. 584 (Fla. 1894). Again a jury question.

C. Rule 405

The case of *Buttrey v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135 (7th Cir. 1969) *cert. den.* 396 U.S. 838, is a direct authority for an implied right of action based on violation of a "self-regulatory rule." It is undisputed that defendant Hentz is a member of the New York Stock Exchange. The claim in *Buttrey*, as in the case at Bar, was based on an allegation that the broker-dealer violated New York Stock Exchange Rule 405, the "know your customer rule." As the Court said in the *Buttrey* case at page 142:

> "The touchstone for determining whether or not the violation of a particular rule is actionable should properly depend on its design 'for the direct protection of investors' . . . Here one of the functions of Rule 405 is to protect the public, so that permitting a private action for its violation is entirely consistent with the purposes of the statute."

Such a possible violation was likewise properly held to be a jury question in the instant case.

D. Liability Under the Florida Acts

The plaintiffs were customers of the Coral Gables, Florida office of defendant Hentz. The cause of action clearly arose in Florida. Petitioners pre-emption argument is absurd.

Section 78(bb) of the 1934 Act specifically reserves the right to the states to have their own Securities laws. Section 517.301 of the Florida Statutes merely traces the language of Rule 10b-5. Had Congress intended to pre-empt the field in the area of Securities law it would have said so.

The conduct of defendants in the instant case clearly presented jury questions on a possible violation of the Florida Statutes. The Circuit Court so held in reversing the trial court and it is respectfully submitted was correct in so doing.

III.

THE COURT HAD JURISDICTION OF CLAIMS ARISING UNDER STATE LAW UNDER PENDENT JURISDICTION.

The defendants also claim in their Petition that the Court lacked jurisdiction to decide any issues under state law because there was not complete diversity between the parties.

In the Complaint, plaintiffs claimed jurisdiction of causes of action arising under state law under the doctrine of pendent jurisdiction.

It is well established law that where there are two distinct grounds in support of a single cause of action and only one presents a Federal question, and the Federal question averred is not plainly wanting in substance, the Federal Court, even though the Federal ground is not established (which it is in our case), may, nevertheless, under the doctrine of pendent jurisdiction, retain and dispose of the case upon the non-Federal ground. *Hurn v. Oursler*, 289 U.S. 238, 77 L.Ed. 1148 (1932).

In this case there was a claim under the Federal Securities Laws. Thus, under the doctrine of pendent jurisdiction, the Court had jurisdiction over questions arising under state law.

CONCLUSION

The Court of Appeals was correct in holding that this case should have gone to the jury. The Petition for a writ of certiorari should be denied.

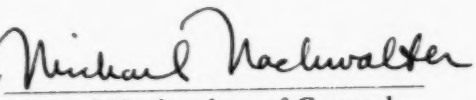
Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that three copies of the foregoing Brief for Respondents in Opposition to Petition for a Writ of Certiorari and Appendix annexed thereto were served upon Sidney M. Aronovitz, Esquire, of Aronovitz, Silver & Booth, 908 Ainsley Building, Miami, Florida 33132, counsel for H. Hentz & Co. and Ralph Nernberg, by depositing same in a United States mail box with first class postage prepaid, addressed accordingly, and in accordance with Rule 33, Supreme Court Rules, this 12th day of June, 1973.

By 

Michael Nachwalter, of Counsel
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1409 Alfred I. duPont Building
Miami, Florida 33131
Attorneys for Respondents

APPENDIX

APPENDIX

475 F.2d 119 (1973)

David KASNER and Joan Kasner,
Plaintiffs-Appellants,

v.

H. HENTZ & CO. and Ralph Nernberg,
Defendants-Appellees.

No. 72-1575.

United States Court of Appeals,
Fifth Circuit.
March 15, 1973.

Rehearing Denied April 4, 1973.

Action by customers against broker and its registered agent to recover for damage allegedly occasioned by agent's false dealings and breach of trust in handling plaintiffs' discretionary stock account. The United States District Court for the Southern District of Florida, Emett C. Choate, J., directed verdict for defendants and plaintiffs appealed. The Court of Appeals, Ingraham, Circuit Judge, held that whether agent had made false statements, whether they were material and whether customers had been justified in their reliance thereon were questions for trier of fact.

Reversed and remanded.

1. Courts

Where jurisdiction was found under Securities Act of 1933 and Securities Exchange Act of 1934, pendent jurisdiction over plaintiffs' counts alleging state securities law violations and common-law negligence was also present in case in which gravamen of complaint was that broker's registered agent had induced plaintiffs to give him trading authority over their stock portfolio and that nine months later their equity had been reduced from in excess of $50,000 to about $3,000. F.S.A. § 517.301; 28 U.S.C.A. §§ 1331, 1337; Securities Act of 1933, § 22(a), 15 U.S.C.A. § 77v(a); Securities Exchange Act of 1934, §§ 10, 15(c)(1, 2), 15 U.S.C.A. §§ 78j, 78o(c)(1, 2).

2. Brokers

In action by customers against broker and its registered agent for damage allegedly occasioned by agent's false dealings and breach of trust in handling customers' discretionary stock account, whether agent had made false statements, whether they were material and whether customers were justified in their reliance thereon were questions for trier of fact; thus the district court should not have granted directed verdict for defendants. F.S.A. § 517.301; Securities Act of 1933, § 22(a), 15 U.S.C.A. § 77v(a); Securities Exchange Act of 1934, §§ 10, 15(c)(1, 2), 27, 15 U.S.C.A. §§ 78j, 78o(c)(1, 2), 78aa.

Michael Nachwalter, Miami, Fla., for plaintiffs-appellants.

Sidney M. Aronovitz, Miami, Fla., for defendants-appellees.

Before BROWN, Chief Judge, and TUTTLE and INGRAHAM, Circuit Judges.

INGRAHAM, Circuit Judge:

Plaintiffs-appellants, customers of H. Hentz & Co., a brokerage firm, brought suit against the firm and Ralph Nernberg, its registered agent, to recover damages allegedly occasioned by Nernberg's false dealings and breach of trust in handling plaintiffs' discretionary stock account. More particularly, plaintiffs sought damages from Nernberg and Hentz on three theories: (1) violations of 15 U.S.C. § 78j, 15 U.S.C. § 78o(c)(1)-(2) and Securities Exchange Commission Rules 10b-5 and 15(c)(1)(2) promulgated thereunder; (2) negligent failure to properly supervise and administer a discretionary account in violation of New York Stock Exchange Rules 401 and 405 and (3) violations of the applicable securities laws, Florida Statutes Annotated § 517.301.

[1] Jurisdiction was asserted and is found under 28 U.S.C. §§ 1331 and 1337; § 22(a) of the Securities Act of 1933 [15 U.S.C. § 77v(a)], and § 27 of the Securities Exchange Act of 1934 [15 U.S.C.§ 78aa]. Pendent jurisdiction over plaintiffs' counts alleging state securities law violations and common law negligence is also present. McCurnin v. Kohlmeyer & Co. — F.2d — (5th Cir., 1973).

The gravamen of plaintiffs' complaint was that after suffering near disastrous losses in the stock market with a portfolio structured for a market decline, Dr. and Mrs. Kasner approached their broker Nernberg in September of 1969, intending to direct him to liquidate their holdings. Rather than lose an actively trading account and its attendant commissions, Nernberg, plaintiffs' allege, induced the Kasners to give him trading authority over their stock portfolio and to restructure it for a rising market. Plaintiffs testified that when they approached Nernberg to liquidate their holdings, he said to them:

> "And he said to me this would be [the] worst mistake you could make. Let me turn it around, and I'll make your money back in two years; and that he would be the manager of the account. He would take it off my hands, I wouldn't have to worry about it, I could go back to my doctoring, and I wouldn't have to look at these statements — I couldn't read anyway — No matter what they said, I couldn't read these statements; I didn't understand them. And so he offered me to take it over, he would manage it — he was an expert, a professional. I'd already learned that I could not handle the account any more; I was an amateur. I couldn't learn enough to handle this stuff. So — And here he was offering me to take it off my hands, take it over, make money back in two years.
>
> "I said, 'Fine, then take it over,' and that's essentially how he got the account."

In support of the Kasner's allegations that Nernberg had induced them to remain in the market with a disastrous result, plaintiffs introduced the discretionary authorization they had executed in Nernberg's favor in September of 1969. They also introduced evidence which showed that when signed over to Nernberg's discretion plaintiffs' portfolio, though below margin requirements, had a net equity in excess of $50,000. Less than nine months later, after active trading by Nernberg and maintenance calls, plaintiffs' equity in the account had been reduced to about $3000. Plaintiffs further showed that all transactions occurring in this period of time were initiated solely by defendant Nernberg under the supervision of Hentz & Co. and that plaintiffs had continued the account only at Nernberg's insistence.

In defense of the action Hentz relied on the testimony of Nernberg that he had not guaranteed results, nor that he had fraudulently or negligently managed the account. Defendants further relied on evidence that in the course of the decline in plaintiffs' equity, they had sent plaintiffs numerous notifications that their account was declining. The defense contended that given such knowledge plaintiffs could not justifiably have relied on Nernberg's management. At the close of the testimony on defendants' motion, the district court granted a directed verdict for the defendants.

[2] We reverse as jury questions on several controverted facts appear in this record. Boeing v. Shipman, 411 F.2d 365 (5th Cir., 1969), required that the case be submitted to the jury, the appropriate forum for determination of whether false statements were made, if so whether they were material, and if plaintiffs were justified in their

reliance thereon. Evans & Co. v. McAlpine, 434 F.2d 100 (5th Cir., 1970); Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876 (2nd Cir., 1972); Robinson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 377 F.Supp. 107 (N.D.Ala., 1971); Hecht v. Harris, Upham & Co., 283 F. Supp. 417 (N.D.Cal., 1968); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bocock, 247 F.Supp. 373 (S.D.Tex., 1965).

In arguments over the motion for directed verdict, plaintiffs suggested that the case already tried be sent to the jury which had heard it, then should the verdict be against defendants the court could properly consider a defense motion for a judgment n. o. v., which, should the court grant it and later be reversed, would obviate the need for a retrial. This suggestion was not followed and we consequently must remand this cause for re-trial.

The order of the district court is reversed and the cause remanded.